VIRGINIA SECTION

ACCOUNTING BETWEEN COTENANTS—SECTION 3294 OF THE CODE OF 1887, GIVING RIGHT THEREFOR, OMITTED FROM CODE 1919—RESULT.—In the February issue of the VIRGINIA LAW REVIEW there appeared an article under the above title, noting the fact that § 3294 of the Code of 1887 had been omitted from the Code of 1919 by the revisors; and stating generally the probable effect of this omission.

But it has been called to our attention that subsequently an act was passed by the Legislature covering this omission.[1]

We wish to correct this mistake herewith and acknowledge our error.

BANKRUPTCY—PREFERENTIAL TRANSFERS AND FRAUDULENT CONVEYANCES—WHAT CONSTITUTE.—It might be of interest to note that, even under the present Federal Bankruptcy Act, and our Virginia Statute of Fraudulent Conveyances, it is possible that a debtor may prefer by a transfer of his property one or several creditors to the exclusion of another, or all others, provided he has not the *actual* intent to hinder, delay, or defraud the others thereby; or further that the creditors who are thus preferred, have not *reasonable cause* to *believe* a preference is thereby being effected. In the first mentioned instance, *actual* fraud must be shown.

Thus in a recent Virginia case,[1] a debtor, at a time when he was insolvent, and when he knew he did not have the present ability to pay all his creditors, made a conveyance of some of his property to a creditor in satisfaction of a pre-existing debt. This transfer was made within the four months period of the filing of a petition in bankruptcy against him. The grantee, or transferee, however, did not know or have reasonable cause to believe he was being preferred. The court held, in accordance with the prevailing decisions on this point, that the conveyance could not be set aside.

In examining this question, and taking up the various grounds upon which this conveyance might have been avoided, it appears that it might have been set aside perhaps under § 60 (b) or § 67 (e) of the Bankruptcy Act, or as a fraudulent conveyance.

It is well settled and unquestioned in the case at bar that under our Statute of Fraudulent Conveyances, and at common law an insolvent debtor, known by himself to be insolvent at the time, may

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[1] Acts 1920, p. 28, provides:
"An action of account may be maintained against the personal representative of any guardian, bailiff, or receiver, and also by one joint tenant, tenant in common, or coparcener, or his personal representative, against the other as bailiff, for receiving more than comes to his just share or proportion and against the personal representative of any such joint tenant or tenant in common."

[1] Surratt *v.* Eskridge (Va.), 108 S. E. 677 (1921).

make a valid conveyance in satisfaction of existing indebtedness, if that is his sole purpose. It may be that it was intended as a preference, and excluded other creditors thereby, but such excluded creditors cannot avoid it on the ground of its being a preference.[2] Where such a transfer is not made with the sole purpose of a bona fide preference among his creditors, but is used as a cloak for some other object which is fraudulent in actual intent, then such a conveyance of property may be avoided.

In the instant case there is no evidence that the debtor had any other design or purpose than the satisfaction of the existing debt.

Section 60 (b) of the Bankruptcy Act provides:

> "If a bankrupt shall have given a preference, and the person receiving it, or to be benefitted thereby, or his agent acting therein, shall have had reasonable cause to believe that it was intended thereby to give a preference, it shall be voidable by the trustee, and he may recover the property or its value from such person."

It is plain that the conveyance in this case could not be set aside under this section. For even admitting that there was a preference, and that the debtor intended to prefer one creditor, and enable him to obtain more than his just share of the assets of the debtor, yet as there was no reasonable cause for the grantee to believe that a preference was intended, this section could not help anyone who sought to avoid the transfer by virtue of its provisions.

Section 67 (e) of the Bankruptcy Act provides:

> "That all conveyances, transfers, assignments, or incumbrances of his property, or any part thereof, made or given by a person adjudged a bankrupt under the provisions of this act, subsequent to the passage of this act, and within four months prior to the filing of the petition, with the intent and purpose on his part to hinder, delay or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, except as to purchasers in good faith and for a present fair consideration; and all property of the debtor conveyed, transferred, assigned, or incumbered as aforesaid shall, if he be adjudged a bankrupt, and the same is not exempt from execution and liability for debts by the law of his domicile, be and remain a part of the assets and estate of the bankrupt, and shall pass to his said trustee, whose duty it shall be to recover and reclaim the same by legal proceedings or otherwise for the benefit of the creditors."

In the case under consideration, there was a transfer of property by the bankrupt, and within four months of the filing of a petition in bankruptcy against him. But in order that a transfer may be set aside by the trustee the conveyance must have been

[2] See 12 R. C. L. 576 *et seq.*; and notes in 11 L. R. A. 467; 36 L. R. A. 335.

made with the intent to hinder, delay or defraud his creditors. So the point to be decided from the facts and evidence was whether or not the bankrupt had such intent at the time he made the transfer; or rather, to be more exact, what is the meaning of the phrase "intent to hinder, delay or defraud his creditors," as used in this section.

By recurrence to the common law and the statutes on fraudulent conveyances generally, we find this a very familiar expression. In connection with conveyances intended to defraud, this phrase has been held to mean that there must be *actual* fraud in order to invalidate such a transfer. The question of fraud depends upon the motive.

It might be argued that while the giving of a preference does not indicate an intention on the part of the grantee to take from the creditors anything to which they might be lawfully entitled, yet if the preference was made in contemplation of bankruptcy proceedings and for the actual purpose of defeating the operation of the act in securing equal distribution of assets, it would be a deprivation of rights and a fraud upon the act. And it would seem that under this section (67 e) read in the spirit of § 67 (c) 3 (avoiding liens which were obtained in fraud upon the provisions of the act) such conveyance might be avoided.

But recurring to the facts of the present case it is seen that the preference was not given with bankruptcy in view.

In might also be contended that as the necessary consequence of the conveyance was to hinder, delay or defraud creditors of the bankrupt in the collection of their debts, the bankrupt must be presumed to have intended such consequences.

But here you are overlooking the vital difference in the provisions of the act, regarding preferences and conveyances. A preference, in order that it may be set aside under § 60 (b) is not necessarily fraudulent. They are set aside, not because they are fraudulent but because it is an infraction of the rule requiring equal distribution of the bankrupt's assets. The fraud in such a case is only technical, or constructive, as violating the policy of the law. However, where there is a fraudulent transfer, there is actual fraud. The bankrupt has secured some advantage or benefit for himself out of that which lawfully belongs to his creditors.

In delivering an opinion as to the proper construction of § 67 (e) the Supreme Court of the United States said:

> "We are of opinion that Congress, in enacting 67e, and using the terms 'to hinder, delay or defraud creditors,' intended to adopt them in their well-known meaning as being aimed at conveyances intended to defraud. In section 60 merely preferential transfers are defined, and the terms on which they may be set aside are provided; in section 67e, transfers fraudulent under the well-recognized principles of the common law and the Statute of Elizabeth are invalidated. The same terms are used in section 3, subdivision 1, in which it is made

> an act of bankruptcy to transfer property with intent to hinder, delay, or defraud creditors. Such transfers have been held to be only those which are actually fraudulent." [3]

This is the opinion of textwriters on the subject.[4] And this was also the conclusion reached by our Supreme Court of Appeals.

The basis of any controversy as to the proper view of the construction of this section must necessarily arise out of the failure to distinguish between the intent to defraud and that to prefer. It is true that in considering whether there was an intent to defraud, the intent to prefer is an important matter to be considered.

> "There is no necessary connection between the intent to defraud and that to prefer, but inasmuch as one of the common incidents of a fraudulent conveyance is the purpose on the part of the grantor to apply the proceeds in such manner as to prefer his family or business connections, the existence of such intent to prefer is an important matter to be considered in determining whether there was also one to defraud. But the two purposes are not of the same quality, either in conscience or in law, and one may exist without the other. The statute recognizes the difference between the intent to defraud and the intent to prefer, and also the difference between a fraudulent and a preferential conveyance. One is inherently and always vicious; the other innocent and valid, except when made in violation of the express provisions of a statute." [5]

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NOTICE AND MOTION—TIME WITHIN WHICH DEFENDANT MUST APPEAR.—Under a proceeding by notice and motion, § 6046 of the Code of 1919 requires that the notice be returned to the clerk's office within 5 days after service, but does not specify any time within which the defendant must appear. Now in regard to the procedure under the usual method of proceeding by writ and declaration, § 6055 of the Code of 1919 provides that "process from any court . . . shall be returnable within ninety days after its date." The question at once arises whether this later section, by analogy, regulates also proceedings by notice and motion, or whether § 6046 is complete in itself, with the necessary consequence that there is no time limit within which the defendant must appear under this section. The mere stating of the question would seem to suggest the answer.

The question above stated was squarely presented in the recent case of *Virginia Hot Springs Co.* v. *Schreck*.[1] It was decided, in an opinion by Judge Burks, that the ninety day clause of § 6055 applied also to the proceeding by notice and motion under § 6046. In the course of the opinion it was said:

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[3] Coder *v.* Arts, 213 U. S. 223, 16 Ann. Cas. 1008 (1909).
[4] COLLIER, BANKRUPTCY (12th Ed.) 1065; 1 REMINGTON, § 1498.
[5] Van Iderstine *v.* National Discount Co., 227 U. S. 575, 582 (1913).
[1] 109 S. E. 595 (1921).